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THE CONVERSION OF THE ENGLISH DEBT.

The remarkable success which has attended Mr. Goschen's recent conversion of the English three per cents. cannot have surprised those who have noted the numerous evidences of the steady downward movement of the rate of interest on all obligations of undoubted security. To those who have not observed this movement, the result of Mr. Goschen's operation is, perhaps, the best evidence of the existence of the fact upon which its accomplishment was conditioned. Quite aside, however, from its importance as an indication and as a measure of this tendency, an operation of such magnitude and consequence, which has radically transformed the English debt and definitively fixed its character for a period of thirty-five years, deserves attention on its own account. It is an example, on a great scale, of almost perfect success in debt conversion. The materials for a survey of it have been carefully collected in a semi-official document, published, with the approbation of the Chancellor of the Exchequer, by an officer of the English Treasury, who enjoyed, as Mr. Goschen tells us, the opportunity of being "behind the scenes all the time" while the negotiations were in progress.*

Mr. Goschen brought forward his plan for the conversion of the English debt on March 9, 1888, in a speech remarkable for its clearness, strength, and precision, and for its luminous historical exposition of precedents in conversion. The stock with which he proposed to deal embraced all that portion of the English debt included in the 3 per cents., and amounting in the aggregate to £558 millions. There were three kinds of this 3 per cent. stock:—

Consols,	£323 millions
Reduced Threes,	69 "
New Threes,	166 "
Total,	£558 millions

A word about the character, origin, and position of these stocks. The English debt has the form of perpetual annuities,

*E. W. Hamilton, *An Account of the Operations under the National Debt Conversion Act, 1888, and the National Debt Redemption Act, 1889.* London. 1889.

subject to redemption at the pleasure of the government on payment of £100 in cash for every £100 of stock. Nearly the whole of the debt in March, 1888, consisted of 3 per cent. annuities. The term "Consols" was commonly applied to 3 per cents. generally,—partly, no doubt, because they made up the great bulk of the 3 per cents., and partly, also, because they had become, as long as a century ago, the traditional 3 per cent. stock of Great Britain. Strictly speaking, however, Consols proper formed only a part, although the most important part, of the English 3 per cent. debt. They were an entirely distinct creation, dating back to an act of 1752, by which various small 3 per cent. stocks were all consolidated into one common 3 per cent. stock, whence the technical designation of Consols. The Reduced Threes had their origin in an operation carried through by Mr. Pelham in 1750, by which various 4 per cents. were reduced to $3\frac{1}{2}$ per cents. for a term of seven years, at the expiration of which they were automatically reduced to 3 per cents. The New Threes were a more recent creation. They resulted from Mr. Goulburn's conversion of the $3\frac{1}{2}$ per cents. in 1844. Mr. Goulburn was then able to require holders of $3\frac{1}{2}$ per cents. to choose between their capital and a new security, bearing interest at $3\frac{1}{4}$ per cent. for a period of ten years, then falling to 3 per cent., and becoming redeemable in 1874. To distinguish them from the other 3 per cents., they took the name of New Threes.

Different conditions attached to each of these different stocks. One of the differences was of the greatest practical consequence. It related to the terms under which the 3s were redeemable. Consols and Reduced Threes could be paid off only after a year's notice, and then in sums of not less than £500,000 at a time. The New Threes, on the other hand, after the expiration in 1874 of the period during which they were guaranteed against redemption, could be paid off at any time, without previous notice and in any amounts.* Such, at any rate, was the contention of the Chancellor of the Exchequer; and his opinion was accepted by Parliament. Full effect had to be given to this existing difference by the gov-

* *National Debt Act*, 1870 (33 & 34 Vict., c. 71) § 5, re-enacting provisions of previous legislation.

ernment in shaping a scheme of conversion. The mere fact that holders of Consols and Reduced Threes were entitled to a year's notice before their stock could be touched had always made it difficult for the English Treasury to grapple with this portion of the public debt. A conversion, to be successful, must be supported by a threat of reimbursement. The power to act suddenly on short notice has been the secret of almost every successful English conversion. But, where a long notice is necessary, it is impracticable to employ the compulsory process. This difficulty, however, had to be overcome in dealing with Consols and Reduced Threes.

Two attempts had been made to reduce the interest on the 3 per cents. before Mr. Goschen approached the problem in 1888. Both had had the most limited degree of success. The first attempt was made by Mr. Gladstone in 1853. The 3s then stood a little above par; and the Chancellor of the Exchequer, being engaged in disposing of another group of stocks, threw open his offer, to a limited extent, to holders of 3s. Not being able to give a short notice, his scheme was, by necessity, purely optional. He offered to convert £30 millions of 3s into any one of three kinds of new stock which he was about to issue, on the following terms: for each £100 of 3s, (1) £110 of $2\frac{1}{2}$ per cent. stock, guaranteed against redemption for a period of forty years; (2) £82½ of $3\frac{1}{2}$ per cent. stock, guaranteed for a similar period; or (3) an Exchequer bond of £100, bearing $2\frac{3}{4}$ per cent. interest until 1864, when it would fall to $2\frac{1}{2}$ per cent. for a further period of twenty years, becoming redeemable in 1894.* This offer, however, did not prove sufficiently attractive to save the operation from comparative failure. Holders of only £1½ millions of 3s, out of a total of some £500 millions, sent in their stock for exchange. The scheme was premature; for the rise of the 3 per cents. was only temporary, and they soon fell again in consequence of the foreign troubles which ended in the Crimean War. Yet the small amount of stock exchanged on this occasion was not without service in indicating to future finance ministers the course of the market.

The next attempt to deal with the 3s was made by Mr.

* *National Debt Act*, 1853 (16 & 17 Vict., c. 23).

Childers in 1884. They then stood $1\frac{1}{2}$ per cent. above par; and the Chancellor of the Exchequer carried through a Conversion Act,* by which, for every £100 of 3s, holders were offered their choice between £102 of $2\frac{3}{4}$ per cents. and £108 of $2\frac{1}{2}$ per cents., the new stock in both cases being irredeemable until 1905. Like his predecessor thirty years before, Mr. Childers pursued the optional course, desiring "to make the first step one of agreement rather than of compulsion." The terms of the offer were liberal. Some confidence was felt by prominent financiers in the success of the scheme, and it was backed by the *Economist*. But the results showed only a very partial success, the failure being attributed to the powerful banking interests that were arrayed against it. No more than £23,300,000 of 3s were sent in for exchange, and one-half of these represented holdings of government offices. Nevertheless, Mr. Childers's scheme paved the way for Mr. Goschen's conversion of four years later. It furnished a most trustworthy and accurate gauge of the state of the public credit, and thus enabled the government, in 1888, "to go forward with a confidence which otherwise it would be difficult for us to feel." It also served as a timely warning to recalcitrant fund-holders. There can be little doubt that the recollection of the refusal of Mr. Childers's better offer, in 1884, accelerated the acceptance of Mr. Goschen's less favorable terms in 1888.

The situation had materially changed, however, since 1884. The state of the public credit and the condition of the market were much more favorable to a successful conversion on a large scale in 1888 than ever before. The general tone of public opinion in 1888, as shown in the operations on the stock market, indicated the existence of a wide-spread feeling that the time for a conversion scheme had arrived. Between the values of stocks resting upon the same security, and differing only as regards the terms under which they were redeemable, there was a divergence whose meaning could not be mistaken. In January, 1884, 3s stood at about $101\frac{1}{2}$, and the $2\frac{1}{2}$ per cents. of 1853 at 90. In October of the same year, when Mr. Childers's operations were well under way, the 3s dropped

* *Debts Conversion Act*, 1884 (47 & 48 Vict., c. 23).

1 per cent., and the $2\frac{1}{2}$ per cents. rose to 93. Four years later, in January, 1888, shortly before Mr. Goschen brought forward his scheme, 3s stood at about $102\frac{1}{2}$, and the $2\frac{1}{2}$ s at about 95. By April of the same year, under the impression produced by the passage of Mr. Goschen's scheme of conversion, Consols fell a point, and the $2\frac{1}{2}$ s jumped to 96, and for a while even stood at 97. The contrast is significant. The $2\frac{1}{2}$ s had gained 6 points in the space of about four years, while the 3s had hardly moved at all. Holders and investors in 3s were becoming apprehensive that they might be disturbed; and Consols were being held down below their natural level by the fear of conversion. The credit of England was better than 3 per cent.; and in March, 1888, Mr. Goschen was convinced that the time had come to give full effect to this fact. He proposed, therefore, to threaten the holders of 3s with reimbursement or conversion.

The difficulty to be encountered in threatening holders of Consols and Reduced Threes has already been described. Neither Mr. Gladstone nor Mr. Childers had felt themselves strong enough to threaten them. Events might easily happen before the expiration of a year's notice that would make a threat by the government worse than nugatory. And yet a scheme of conversion, unsupported by a threat of reimbursement, was of extremely uncertain issue. So far as was safe and practicable, Mr. Goschen was determined to employ the compulsory process. Dealing with the holders of New Threes in a strong market, he felt himself able to compel them to choose between their capital and a new stock. But, knowing too well the enormous pressure that might be exercised against him by the Consol-holders, and the dangers to be encountered in compulsory procedure against them, he had no desire to stake the success of his scheme upon a threat. Unable or unwilling to coerce, he decided to induce. It is obvious that the task of the government would be greatly simplified if the holders of Consols and Reduced Threes could be induced to forego their right of notice for one year, and accept the same terms as were offered to holders of New Threes. So valuable did Mr. Goschen consider this right of notice that he was willing to allow those entitled to it a bonus of $\frac{1}{4}$ of 1

per cent. on their principal, if they would forego it. This was the characteristic feature of his measure, and the one that had, perhaps, most to do with its success.

Some other features of Mr. Goschen's plan need to be noticed. From the very outset, he was determined that conversion should be effected without any augmentation of the capital of the English debt. In this respect, he prudently departed from the most recent precedents. In another important particular, he also avoided the example of his predecessors. Both Mr. Gladstone and Mr. Childers had given holders a choice among different kinds of stock. But simplicity was to Mr. Goschen's mind one of the secrets of success; and, as he was especially desirous, for other reasons, of amalgamating all of the 3s into one great stock, he preferred to offer one common stock for all. In fixing the rate of interest the new stock should bear, difficulties presented themselves. A rate of $2\frac{1}{2}$ per cent. seemed to be lower, one of $2\frac{3}{4}$ per cent. higher, than the national credit justified. In solving the question of interest, Mr. Goschen followed the successful precedents of Mr. Pelham in 1750 and Mr. Goulburn in 1844. He proposed to reduce the interest on the new security to $2\frac{3}{4}$ per cent. for a term of fourteen years, beginning with 1889, and then to let it descend automatically to $2\frac{1}{2}$ per cent. in 1903, at which rate it should continue for a term of twenty years, becoming redeemable in 1923.

Such were the leading features of the scheme proposed by the Chancellor of the Exchequer on March 9, 1888, and adopted by Parliament, with a few minor modifications, in the National Debt (Conversion) Act of March 27, 1888 (51 Vict., c. 2). The act dealt separately with the holders of New Threes on the one hand, and with holders of Consols and Reduced Threes on the other. The compulsory process of conversion was employed against the former class of holders alone. They were required to choose between their capital and the new stock, ten days (with special provisions in the case of persons absent from the country) being allowed them to signify dissent from the terms offered by the government. Silence was construed by the act to mean assent. Dissentients were to be paid off, at such times and in such sums as the

Treasury might direct, before August 1, 1888. In the case of Consols and Reduced Threes, where the arrangement was purely voluntary, and where the initiative rested with the holder, and not with the government, the mode of procedure was reversed; and here silence was construed to mean dissent. Holders of Consols and Reduced Threes were allowed until April 12, 1888, to express their assent, with special provisions in certain cases.

The scheme of conversion was received with favor by the general public. It was at least acquiesced in by London bankers, and the small annuitants were more than likely to follow the lead of the large holders. A significant fact was a rise, even before the passage of the Conversion Act, in the prices of most securities of the highest character, those which might in some sense be considered competitors of the new stock to be issued by the government. But perhaps the most promising indication of the success which awaited the scheme was the fact that the New Threes continued to stand above par even after notice of compulsory conversion had been given by the Treasury. Investors seemed to be willing to pay a premium for the opportunity of acquiring the new $2\frac{3}{4}$ per cents. Under these circumstances there were likely to be few dissentients. Holders of 3s wishing to dispose of their stock could do so in the open market on more advantageous terms than those offered by government.

The success of the operation on that portion of the stock on which the compulsory process was employed was complete. Out of a total of £166 million of New Threes, the dissentients represented an aggregate holding, all told, of not more than £761,000. No effort was made either to defy or to corner the Treasury. Indeed, it was too well known that the Chancellor of the Exchequer had large and substantial resources at his command, which he was determined to use in case of necessity. But, after all, the great success of the operation was chiefly due to the solid basis upon which it rested. The market for sound securities was extremely strong, and the field for investment in safe stocks limited. It would have been a serious question with large holders, who might have elected reimbursement in preference to conversion, where they could have

found safe investments under the circumstances. Mr. Goschen, from the first, never apprehended that there would be any large number of dissentients.

The self-interest of the holders, which had produced such successful results with the New Threes, was the sort of compulsion which Mr. Goschen had rightly relied on to assure the success of his operation with reference to the Consols and Reduced Threes, in spite of their option of a year's notice, and in spite of the pressure they might have exercised to defeat his scheme, as they did that of Mr. Childers in 1884. In 1888, they had nothing to gain and much to lose by holding out against the offer of the government. The conversion of Consols and Reduced Threes, therefore, went ahead rapidly. On April 15, 1888, the Chancellor of the Exchequer announced that assents from holders representing £307 million of these stocks had been received. During the next two months, £38 million more were sent in for exchange, thus reducing the outstanding balance of unconverted 3s to £46.5 million. The final results of the conversion operations were exhibited in a Treasury return dated November 5, 1888.* From this return, it appears that, out of a total amount of £592,618,286 † of 3 per cent. stock dealt with under the Conversion Act, £549,094,010 were converted into $2\frac{3}{4}$ per cent. stock, and that only £42,325,173 were left to be otherwise dealt with.

Amount of 3 per cents. on March 31, 1888, . . .	£557,992,508	
Add Consols created on Chancery account, . . .	34,625,777	
Total amount of 3 per cents. liable to conversion,		£592,618,285
Amount of 3 per cents. converted into New $2\frac{3}{4}$		
per cents.,	£549,094,110	
Add: 1. Consols and Reduced Threes cancelled		
by the action of the sinking fund be-		
tween March 31 and November 5, 1888,	437,417	
2. New 3 per cent. dissentients paid off, . .	761,683	
Total amount of 3 per cents. converted or paid		
off between March 31 and November 5, 1888,		550,293,210
Total amount of 3 per cents. outstanding and		
unconverted on November 5, 1888, . . .		<u>£42,325,075</u>

* *House of Commons Paper*, c. No. 5584, Session 1888.

† This total includes £34,625,777 of Consols, mentioned in the table, which were temporarily created in respect of certain Chancery terminable annuities, in order that they might be exchanged for new $2\frac{3}{4}$ per cent. stock. *National Debt (Supplemental) Act*, 1888.

The first stage of the operation was thus completed: thirteen-fourteenths of the three per cents. had been brought in for conversion, leaving only a fraction to be disposed of by redemption. As early as June 1, 1888, it had become evident that the amount of 3s not sent in for exchange would be comparatively small;* and it was therefore felt to be both safe and expedient to give the required notice of redemption to holders of Consols and Reduced Threes. On July 5, a carefully worded notice, repeating the language of the acts of 1749 and 1752, was adopted by the House of Commons, certified by the Speaker, and posted on the Royal Exchange, thus giving the required notice. This resolution, however, conferred no power upon the Chancellor of the Exchequer to pay off the 3s. That was still left for a subsequent act. But Mr. Goschen was so anxious to begin the reduction of the outstanding 3s at the earliest moment that he did not wait for the grant of special authority, but availed himself at once of the general discretionary powers of the Treasury. His whole policy from this time was to minimize the demands for cash that might be made on the Treasury at the expiration of the year's notice. He offered to discount, in cash or in local loans, stock claims not maturing until the following year. In this manner, a large block of stock was got out of the way before operations were begun under the Redemption Act proper.

The National Debt Redemption Act (52 Vict., c. 4), providing for the payment of the outstanding balance of unconverted 3s, was passed on April 11, 1889. Holders were given from July 6 to October 1, 1889 (almost three months), to claim their redemption money. All 3 per cent. stock not presented by the latter date was to be automatically converted into the new 2 $\frac{3}{4}$ s. In framing the measure, provision was also made for anticipating redemption payments, in order to avoid, so far as was practicable, the inconvenience of exposing the Treasury to a sudden demand for cash on July 6, 1889 (the day when the year's notice would expire). The Chancellor of the Exchequer was empowered to discount 3s in advance,

* Up to June 1, assents from holders representing £268,267,343 of Consols and Reduced Threes had been passed and recorded.

"with such consideration for the proportionate part of dividend accrued up to date of payment as may be agreed upon between the Treasury and the stockholder."* In order to lessen still further the demands for cash, provision was made for continuing as a 3 per cent. "book debt" until April 5, 1890, £6,376,143, consisting of "stocks in court" and stocks belonging to depositors in savings-banks.† Ample discretionary powers were given to the Treasury, in order that it might give full effect to the provisions of the act. The Chancellor of the Exchequer might raise the means of payment in a variety of ways. He might create and sell new $2\frac{3}{4}$ per cents. to an amount not exceeding the nominal capital of outstanding 3s. He might issue Exchequer bonds, Exchequer bills, or Treasury bills, and he was also authorized to negotiate short loans (to run for a period not exceeding one year) on the credit of the Consolidated Fund. He was not restricted to any one form of borrowing, but might employ "all and any such means."

Mr. Goschen immediately proceeded to avail himself of the power of paying off holders of 3s in advance. He issued a notice on April 26, in which he offered to purchase, on May 14, £15 million of stock at par, including interest accrued up to date. This offer was accepted by holders of £5,444,454 of Consols; and they were accordingly paid off, chiefly out of the proceeds of a £5 million loan of Treasury bills, issued in equal amounts of nine and twelve months' bills, and floated at an average rate of about $2\frac{3}{4}$ per cent. Encouraged by the result of this operation, he reopened his offer in a slightly altered form on May 15, with the result that £683,550 more were paid off in advance. A still further reduction was effected by the conversion of £8,164,312 of 3s held by the National Debt Commissioners into new $2\frac{3}{4}$ per cents., the exchange being arranged on the basis of £99 of the former for £100 of the latter. As the combined result of these advance operations, £20,668,459 of stock had been disposed of before

* *National Debt Redemption Act*, 1889 (52 Vict., c. 24), § 2.

† These have since been converted into the new $2\frac{3}{4}$ per cent. stock to the extent of £5,785,689.

the day of redemption arrived, reducing the amount then to be dealt with to easily manageable proportions:—

Total amount of outstanding unconverted 3s, November 5, 1888,	£42,325,173
I. Paid off in money:—	
1. Under the operation of the sinking fund between November 5, 1888, and July 6, 1889,	£1,356,462
2. Under the offers of April 26 and May 15, 1889,	6,128,005
II. Exchange of 3s held by National Debt Commissioners for new $2\frac{3}{4}$ per cents., .	8,164,312
III. "Book debt" created in respect of "stocks in court" and stocks belonging to de- positors in savings-banks,	6,376,143
Total reduction effected by July 6, 1889, . . .	22,024,922
Total cash liability of the Treasury July 6, 1889,	<u>£20,300,251</u>

The further steps of this remarkable operation may be stated briefly. Of the total cash liability, £576,365, representing "unclaimed stocks" which had accumulated in the hands of the National Debt Commissioners, were automatically converted into new $2\frac{3}{4}$ per cents. October 3, 1889. Claims for redemption money were sent in by holders of £11,849,775. Holders of the remaining balance of outstanding 3s, £7,849,775, allowed their stock to be automatically converted into new stock. Finally, claims for redemption money in respect of the "book debt" were sent in for £589,400. From the figures now before us we can ascertain how much actual cash was called for in carrying out the conversion:—

1. Under <i>National Debt (Conversion) Act</i> , 1888: new 3 per cent. dissentients paid off,	£761,683
2. Under <i>National Debt Redemption Act</i> , 1889:—	
(a) Before July 6, 1889,	6,128,005
(b) On and after July 4, 1889,	11,874,109
(c) In respect of the "book debt" created under the National Redemption Act, 1889,	590,454
Total,	<u>£19,354,251</u>

England, then, got out of her unprecedented operation, involving over £592 million of stock, with a payment in cash, exclusive of the ordinary action of the sinking funds, of less than £20 million, or about one-thirtieth of the capital dealt with. In raising the means for this payment, Mr. Goschen had recourse to various expedients. He made several issues of Treasury bills and Exchequer bonds; he received temporary accommodations from the Bank of England, as well as advances from the National Debt Commissioners, whose balances had been allowed to accumulate; and, finally, he made a small issue of new $2\frac{3}{4}$ per cents. The amounts raised in each of these ways were as follows:—

Treasury bills,	£7,346,000
Exchequer bonds,	6,001,768
Loans from National Debt Commissioners,	3,200,000
Loans from Bank of England,	2,800,000
New stock created,	520,184
Total borrowed,	<u>£19,867,952</u>

This is larger than the floating debt of England has been for years; and, under the pressure exerted by it upon the money market, the average rate of discount on Treasury bills went a little higher than usual, averaging during the latter half of the year 1889 a trifle more than 3 per cent. But this loss on the stock redeemed is insignificant, when the magnificent results of the operation as a whole are taken into consideration. Looked at in its practical aspects, it is true, as the *Economist* says, “that the cheapness of the conversion has been as remarkable as its completeness.”

A. C. MILLER.